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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

STATE OF TEXAS AND TEXAS STATE
PERMANENT SCHOOL FUND,
Petitioners,
v.

TABASCO CONSOLIDATED INDEPENDENT
SCHOOL DISTRICT,
Respondent

Petition for Writ of Certiorari to the United States Circuit
Court of Appeals for the Fifth Circuit, and
Brief Thereon

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*To the Honorable Supreme Court of the
United States:*

The Attorney General of Texas, on behalf of the State of Texas and Texas State Permanent School Fund, prays that a writ of certiorari issue to review the final judgment and decision of the United States Circuit Court of Appeals for the Fifth Circuit entered on May 2, 1944, (R. 61) in cause No. 10,802 on the docket of said court, affirming the judgment of the United States District Court for the Southern District of Texas. (R. 46).

This petition is filed pursuant to an Act of Congress of February 13, 1925, and its various amendments. (U.S.C., Title 28, Sec. 347).

The petitioners are represented by the Attorney General of Texas, whose residence is Austin, Texas.

The respondent, Tabasco Consolidated Independent School District, is a municipal corporation, and is represented by its attorney, Honorable C. M. Thompson, of McAllen, Texas.

RECORD

This cause involves alone the question of the validity of the order of the trial court, which was approved by the Circuit Court, which approved a plan of composition of its debts, submitted by petitioner, a local taxing unit in Texas.

The transcript of record on first appeal was expensive to print. Counsel for all parties, as well as the Circuit Court, agreed that the transcript of record on first appeal might be used as a portion of the transcript of record on last appeal.

For convenience petitioner has marked the original record as Volume 1 and the last record as Volume 2 and reference to the original record in the following petition and brief is (O.R.) and to the new or last record as (R).

Petitioners are filing herewith a certified copy of the record in said two volumes from the Clerk of

the Circuit Court for the Fifth Circuit, together with eight extra printed copies of said records.

STATEMENT OF THE MATTERS INVOLVED

Respondent, as plaintiff below, and as appellee in the Fifth Circuit Court of Appeals, instituted this suit on June 15, 1940, for a composition of its debts, under Chapter X of the National Bankruptcy Act, approved July 1, 1898, as amended by Public No. 302 of the 75th Congress, approved August 16, 1937, as amended by the Chandler Amendment, changing Chapter X to Chapter IX. (O.R. 3-11).

On July 25, 1941, the respondent filed its First Amended Original Petition and Plan of Composition. (O.R. 32-39).

On August 16, 1941, the District Court for the Southern District of Texas entered an interlocutory decree confirming the amended plan of composition filed July 25, 1941. The plan, approved on August 16, 1941, permitted the RFC to retain \$16,000.00 in warrants until or unless the respondent refunded same at 65c on the dollar.

It found that the District owed \$459,000.00 in bonds, and that same were owned by the RFC and the Texas State Permanent School Fund, and provided that the respondent could take bonds of the RFC at 65c on the dollar of the principal of said bonds, bearing 4% interest, and that the Texas State Per-

manent School Fund should take 65c on the dollar in cash. (O.R. 44-50).

The petitioner, Texas State Permanent School Fund of Texas, appealed from said interlocutory decree, and the Fifth Circuit Court of Appeals reversed the judgment of the trial court. (See Opin. 132 F. (2) 62, and 133 F. (2) 196).

The respondent, School District, on April 27, 1943, filed its Supplemental Petition. (R. 4-6).

On May 5, 1943, the petitioner filed its protest to the amended plan of composition. (R. 7-11).

On June 22, 1943, the District Court of the United States for the Southern District of Texas refused to hear any evidence as to the then solvency of the School District, or its ability to pay more than 65c on the dollar of its indebtedness, and entered its interlocutory decree, in all things confirming the amended plan of composition of the respondent, which required bondholders to take 65c on the principal of their bonds in full settlement. (O.R. 46-50).

The Circuit Court of Appeals for the Fifth District on May 2, 1944, affirmed the judgment of the trial court, (R. 61) and on May 25, 1944, overruled petitioners' motion for rehearing. (R. 67).

QUESTIONS PRESENTED

POINT ONE: The error of the court in holding that the question of the financial condition,

and the solvency of the petitioner, Tabasco Consolidated Independent School District, relative to its ability to pay its debts, should be controlled by its financial condition at the time the original petition was filed in 1940, or when its first amended petition was filed in 1941, rather than its financial condition when its final amended petition for composition was filed and approved in May, 1943.

POINT TWO: The error of the court in refusing to hear evidence pertaining to the financial condition and the solvency of the Tabasco Consolidated Independent School District in May, 1943, when the final plan of composition was approved by the trial court.

POINT THREE: The error of the court in holding that the evidence showed that the Tabasco Consolidated Independent School District was not able to pay more than 65c on the dollar of its indebtedness.

POINT FOUR: The error of the court in holding that the plan of composition approved was fair to the State Permanent School Fund of Texas, because it appears that the bonds held by the RFC bore interest at from one to five per cent per annum, and all of the bonds held by the Texas State Permanent School Fund bore five per cent, and none of the interest had been paid for more than four years. The record shows that the RFC purchased its bonds at 65c on the

dollar, presumably because of the small interest rate said bonds bore. The plan approved by the court required the Texas Permanent School Fund to accept 65c on the dollar of its principal, and allow the RFC the same price, plus allowing the RFC to collect 65c on the dollar on \$16,000.00 illegal and uncollectible warrants, which it held.

REASONS WHY WRIT SHOULD BE ALLOWED

1. The United States Circuit Court of Appeals for the Fifth Circuit has decided a question of procedural law relative to the application of the Bankruptcy Act, which permits local taxing units of a state to have a composition of its debts, which is of momentous importance, said court having held that the question of the solvency of the local taxing unit should be governed by its condition at the time its original petition for composition was filed, rather than at the time the final amended plan of composition was approved by the trial court.

2. The Circuit Court of Appeals has held that although the law in Texas, under which the Tabasco Consolidated Independent School District was created, required the District to levy a tax of \$1.50 to pay its bonded indebtedness, said District could use the larger portion of said tax for its maintenance, and divert same from the payment of its bonded indebtedness.

3. The Circuit Court of Appeals has held that the

Tabasco Consolidated Independent School District was insolvent and unable to pay more than 65c on the dollar of its principal indebtedness, although the record shows the district is solvent as revealed by the following facts.

The total budget expense for running the school is \$13,400.10 (O.R. 144). The outside amount required to service all the outstanding bonds is \$22,537.57—total expense \$65,937.57.

The district received from the state school apportionment for operating expenses \$27,000.00 and the tax rate of \$1.50 on the \$3,000,000.00 assessed property values would produce \$45,000.00 (O. R. 145), a total income of \$72,000.00.

Petitioner submits the above, clearly demonstrates that the plan of composition approved, which required the State Permanent School Fund to accept 65c on the dollar of the principal of its 5% bonds, is neither fair, nor just, nor allowable under the Bankruptcy Act.

4. The Circuit Court of Appeals has erroneously held that the Tabasco Independent School District, in direct violation of the Texas statute creating said District, could take the tax levied and collected under the law to pay bonds, and use same for the maintenance of the schools, and thereby divert said tax money to other and different purposes than those for which it was collected.

WHEREFORE, petitioners respectfully pray that a writ of certiorari be issued to the honorable Circuit Court of Appeals for the Fifth Circuit by this court, and upon final hearing the judgment of the Circuit Court, as well as the judgment of the trial court, be reversed, and the plan of composition approved by said court be in all things denied.

Respectfully submitted,

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Permanent School Fund.





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BRIEF FOR PETITIONERS

*To the Honorable Supreme Court of the United
States:*

Petitioners present this brief in support of their petition for writ of certiorari to the United States Circuit Court of Appeals for the Fifth District.

OPINIONS OF THE COURT BELOW

This cause has been before the Court twice. The first amended plan of composition filed by the respondent was approved by the trial court and re-

versed by the Circuit Court, 132 F. (2) 62, and 133 F. (2) 198. The mandate of the Circuit Court reversing said judgment appears in the transcript. (R. 41). For opinion of the Circuit Court on the last appeal, see transcript, (R. 59). The judgment of the Circuit Court of Appeals on the last appeal appears in the transcript (R. 61). Petitioners' motion for rehearing appears in the record, (R. 62). The order denying petitioners' motion for rehearing appears in the record, (R. 67).

JURISDICTION

The judgment and decree to be reviewed was rendered by the Fifth Circuit Court of Appeals on May 2, 1944. Petitioners' motion for rehearing was overruled on May 25, 1944, (R. 61-67). The jurisdiction of this court is invoked under Section 240 of the Judicial Code, as amended by the Act of February 13, 1925, and its other various amendments. (U.S.C., Title 28, Sec. 347).

THE FACTS

Paragraph 403, Title 11, of the Bankruptcy Act, (being Chapter 10 thereof) provides the machinery by which Local Taxing Agencies may effect a plan for the composition of their debts. Said Act requires the petition to state the plan of composition proposed, and it must allege that at least fifty-one per cent of its creditors have agreed to same in writing.

Under Section (e) of said paragraph, before the

trial court is authorized to confirm the plan of composition, it must be shown at the conclusion of the hearing on the application that, "(1) the plan is fair, equitable, and for the best interests of the creditors, and does not discriminate unfairly in favor of any creditor or class of creditors; (2) that it complies with the provisions of this (Bankruptcy) Chapter; * * * (5) that the offer of the plan and its acceptance is in good faith."

In the case at bar it appears that respondent filed its first petition on June 15, 1940. Under the original plan respondent proposed to issue bonds payable to the RFC, which owned 92% of respondent's \$459,000.00 bonded indebtedness to pay 65c on the dollar of the principal, and pay 65c on the dollar for \$16,000.00 outstanding time-warrants held by the RFC. (O. R. 3-24).

On July 7, 1941, the District Court heard the evidence on the original plan of composition (O. R. 55-103). At the conclusion of said original hearing the court stated that counsel could look into the question of amending the proposed plan of composition so as to eliminate the \$16,000.00 in time-warrants. (R. 103).

On July 25, 1941, the trial court resumed the hearing on the original plan of composition, and counsel for respondent stated that it desired to and it did file an amended plan of composition, leaving the \$16,000.00 in warrants out of the bond issue, said

amended plan of composition having been filed in the court on July 25, 1941. (O. R. 32).

The trial court heard additional evidence on the amended plan on July 25, 1941. (O. R. 141-158). On August 16, 1941, the trial court entered its interlocutory decree approving said amended plan of composition, which was filed on July 25, 1941. (O.R. 44-50). Under the plan, as approved by the court in August, 1941, the RFC was given 4% bonds for its outstanding bonds, which previously bore from one to five per cent interest, and permitted it to retain the \$16,000.00 of time-warrants until it received refunding time-warrants therefor at 65c on the dollar. Petitioner Texas Permanent School Fund was given 65c on the dollar in cash for the principal of its outstanding bonds. (O.R. 44-50).

On appeal the Circuit Court of Appeal for the Fifth District reversed the judgment of the trial court for the sole reason that, under the plan as approved by the trial court, it gave the RFC 4% interest-bearing bonds for 65c on the dollar of its principal debt, and gave the Texas Permanent School Fund 65c on the dollar in cash. (See Original Opinion, 132 F. (2) 62). The mandate of the Circuit Court on the first appeal stated:

“On consideration whereof, it is now here ordered, adjudged and decreed by this court, that the judgment of the said District Court appealed from in this cause be, and it is hereby, remanded to said District Court for further pro-

ceedings not inconsistent with the opinion of this court." (R. 42).

After the case was reversed the respondent filed what it termed a supplemental petition, (R. 4) in which it stated that the Board of Trustees had adopted a resolution amending the plan of composition sought to be confirmed, and then set out said resolution, which, after stating certain "whereases," used the following words:

"The District proposed to pay each of the holders of its outstanding bonds, either in cash or in 4% serial bonds, the sum of Sixty-five (65c) cents for each One (\$1.00) Dollar of the principal amount of their respective claims with interest on the reduced amount at Four (4%) per cent per annum from May 20, 1940, until date of said refunding bonds. Any holder of the old bonds electing to receive cash in lieu of refunding bonds will be paid interest thereon at Four (4%) per cent from May 20, 1940 until the money is available to take up the old bonds." (R. 6).

On May 5, 1943, the respondent filed its first amended contest to the approval of the plan of composition as finally amended on April 27, 1943, in which it specifically denied, first, that the respondent was insolvent and unable to meet its debts, as they have matured or will mature; second, it pleaded that the proposed plan was ambiguous, uncertain, and gave no definite plan; third, that since the original petition was filed, and since the former hearing in 1941, the taxable property values in respondent's district had greatly increased, and that under the

then-present conditions the District was solvent and abundantly able to pay all of its outstanding indebtedness in full, and if not, was able to pay a much larger percentage thereof than 65c on the dollar; **fifth**, it alleged that the District had collected and had on hand a sufficient amount in cash to make a substantial payment on all its outstanding obligations, and that before any plan of composition was approved the respondent should be required to reduce its outstanding indebtedness with said funds; **sixth**, it specifically denied the eligibility of the \$16,000.00 in warrants held by the RFC to participate in any of the assets of the District, because said warrants were illegal and void; **seventh**, it specifically alleged that in the original petition filed the respondent District stated it could borrow \$308,750.00; that under the present plan proposed, it was offering to borrow only \$298,000.00, and it alleged that since said District could borrow the larger amount, it should be required to do so. (R. 7-11).

Upon the hearing of the final amended plans for composition on June 12, 1943, the trial court in its Findings of Fact and Conclusions of Law stated that:

“The State of Texas holder of the other 7.48% of such securities did not accept but appeared to contest the confirmation of the Plan. Counsel for the State of Texas stated to the court that it desired to offer evidence seeking to show petitioner was not insolvent at the time of filing the original petition for composition or at the time the Amended Plan of Composition was filed, or at the time of the original trial, and that it was not insolvent at the present time, and that it had

funds on hand with which to pay the larger part if not all of the delinquencies on its outstanding bonds, and show that the financial condition of the petitioner had greatly improved since the filing of the original petition, and that the petitioner was able to pay said bonds in full.

"I ruled that under the opinion of the Circuit Court of Appeals all questions were foreclosed and to be regarded as disposed of save and except only the question of the amendment of the plan placing the State of Texas on the same basis as the RFC, and heard evidence only on that question and declined to hear evidence on any other question." (R. 44-45).

The respondent School District was created by a Special Act of the Legislature in 1926, and under its terms the District was authorized to vote bonds that could be serviced at a tax-rate assessment of \$1.50 on the hundred dollars; said Act provided specifically that if bonds were voted, all of said tax should be used first to service said bonds. Said Act may be found in the Special Laws, 39th Legislature, Chapter 2, p. 4 of the Texas Legislature. The material portion thereof is embraced in Section 7, which reads in part as follows:

"Sec. 7. * * * Said Tabasco Independent School District shall have the right and power to levy taxes at the rate of not exceeding, for any one year, one and one-half ($1\frac{1}{2}$) per cent of the total assessed valuation of all taxable property within said consolidated district for the purpose of the maintenance of the public free schools within said district, * * * and, said

Tabasco Consolidated Independent School District shall have the right and power to levy taxes at the rate of not exceeding, for any one year, one and one-half per cent (1½%) of the total assessed valuation of all taxable property within said consolidated district for the purpose of paying the current interest on and provide a sinking fund or funds sufficient to pay the principal of any and all bonds issued and to be issued by said consolidated district for the purpose of purchasing, constructing, repairing, and equipping public free school buildings within said district and purchasing sites (sites) therefor; provided, however, that the aggregate amount of maintenance tax together with the bond tax of said district shall never exceed, for any one year, one and one-half per cent (1½%) of the total assessed valuation of all taxable property within said consolidated district. * * * It is further provided that when the total rate of bond tax necessary to pay the current interest on and provide a sinking fund or funds to redeem all bonds authorized in said district, together with the rate of maintenance tax authorized and levied, shall ever, for any one year, exceed a combined tax rate of one and one-half per cent of the total assessed valuation of all taxable property within said district, then such total rate of bond tax levied and found necessary for bond purposes shall operate to reduce the maintenance tax rate to the difference between such total rate of bond tax and said tax limitation of one and one-half per cent (1½%) of said total assessed valuation of all taxable property within said district."

The only evidence respondent offered in the trial court to show its insolvency was Mr. Walker, the

Secretary of its Board. He summarized the financial condition of the respondent School District, as follows:

He stated that he had prepared and worked out the budget for the operation of the school, and he gave each separate item which he said totaled \$43,400.00 per annum. (O.R. 144). He testified that the District obtained from the State's apportionment of school funds \$27,000.00 per year; that the total assessed value of the property in the District was \$3,000,000.00; that at the \$1.50 rate this would produce \$45,000.00, (O. R. 145). He testified that to service all of the outstanding \$459,000.00 bonds due the District, the highest average annual debt service would be \$22,537.50, (O.R. 82).

STATEMENT, ARGUMENT AND AUTHORITIES UNDER POINTS ONE AND TWO

POINT ONE (restated): The error of the court in holding that the question of the financial condition, and the solvency of the petitioner, Tabasco Consolidated Independent School District, relative to its ability to pay its debts, should be controlled by its financial condition at the time the original petition was filed in 1940, or when its first amended petition was filed in 1941, rather than its financial condition when its final amended petition for composition was filed and approved in May, 1943.

POINT TWO (restated): The error of the court in refusing to hear evidence pertaining to the finan-

cial condition and the solvency of the Tabasco Consolidated Independent School District in May, 1943, when the final plan of composition was approved by the trial court.

Petitioners submit that under the plain, unambiguous language of the Act of Congress, the question of the solvency of the local taxing agency and its ability to pay its obligation must be and should be determined as of the date the trial court approves the plan of composition.

Title 11, Chapter 10, paragraph 403, of the Bankruptcy Act, provides in detail for the necessary steps, requirements and conditions upon which the trial court can permit a local taxing unit to obtain a composition of its debts, and gives the rules of procedure, which the trial court is required to follow.

Subsection (e) reads:

“At the conclusion of the hearing, the judge shall make written findings of fact and his conclusions of law thereon, and shall enter an interlocutory decree confirming the plan if satisfied that (1) it is fair, equitable, and for the best interests of the creditors and does not discriminate unfairly in favor of any creditor or class of creditors; (2) complies with the provisions of this chapter; * * * (5) the offer of the plan and its acceptance are in good faith; * * *.”

Petitioners submit that the Bankruptcy Act is purely an equitable proceeding which gives local taxing units an opportunity to be relieved of debts that

have accumulated, and which the District is unable to pay. In order for a local taxing unit to scale down its debts, it should be required to, and petitioners submit the Act of Congress does require, the local taxing unit to show at the time the plan is approved that it cannot pay more than the approved plan of composition requires.

In the case at bar the record shows that the original petition and plan of composition was filed in June, 1940. (O.R. 3-11). No action was taken thereon until July, 1941, at which time the trial court refused to approve the original plan and permitted the respondent to file an amended plan, (O.R. 32, and O.R. 143).

On August 16, 1941, the trial court entered its interlocutory decree approving the first amended plan of composition, which permitted the RFC to retain \$16,000.00 of time-warrants, which, as a matter of law, were illegal and uncollectible, until the respondent executed refunding warrants to the extent of 65c on the dollar therefor. It provided that the respondent School District could issue and sell refunding bonds to the RFC in a sufficient amount to pay its \$459,000.00 in outstanding bonds at 65c on the dollar, giving to the RFC 4% bonds, and requiring the petitioner State Permanent School Fund to accept 65c on the dollar in cash. (O.R. 46-48).

On appeal to the Circuit Court of Appeals for the Fifth District, said court reversed the judgment of the trial court, and stated in its opinion that the case

was being reversed for the sole reason that the plan of composition had given the RFC 4% bonds, and had required the petitioner State of Texas to accept cash at 65c on the dollar for its principal bonds, and ordered the cause reversed, in order that the District might, if it desired, amend its plan in respect thereto. (See Opin. of the Court, 132 F. (2) 62, and 133 F. (2) 196).

The mandate issued by the Circuit Court, when it reversed said judgment, stated:

“It is now here ordered, adjudged and decreed by this court, that the judgment of said District Court appealed from in this case be, and the same is hereby reversed; and this cause be, and it is hereby, reversed to the said District Court for further proceedings not inconsistent with the opinion of this court; * * * ” (R. 42).

After the cause was reversed the respondent on April 27, 1943, filed the following supplemental petition or amendment to its plan of composition:

“The District proposes to pay each of the holders of its outstanding bonds, either in cash or in 4% serial bonds the sum of 65c for each one dollar of the principal amount of their respective claims, with interest on the reduced amount at 4% per annum from May 20, 1940, until date of said refunding bonds. Any holder of the old bonds electing to receive cash in lieu of refunding bonds will be paid interest thereon at 4% from May 20, 1940, until the money is available to take up the old bonds.” (R. 5-6).

The petitioners State of Texas and Texas Permanent School Fund opposed the amended plan of composition and asked for the privilege of showing that the plan was not fair, was not the most that the petitioner School District could pay, and that the School District was not insolvent, and that the proposed plan gave the RFC the advantage, and that the District in May, 1943, was entirely solvent and able to meet all of its obligations, and if not, could at least pay a much more substantial sum than that proposed; and further that the School District had accumulated and had on hand a sufficient fund in cash to pay the larger portion of all the delinquencies that had then accrued on said bond obligation. (R. 7-11).

The trial court refused to hear any evidence on the issues raised by the petitioner State of Texas and Texas Permanent School Fund, stating that in his judicial opinion he was bound by the fact-findings made by the trial court in August, 1941. (R. 44-45).

Under the well-recognized rule, since the trial court refused to hear evidence on the tendered defenses, the courts take judicial knowledge of the fact that the petitioner could have and would have shown by competent evidence that the facts alleged in the defense were true.

Petitioners therefore submit that in an equitable proceeding such as this the trial court committed error and the Circuit Court also committed error in

approving a plan of composition for the respondent School District, when it is shown without dispute that it had not paid any interest on its \$459,000.00 outstanding bonds for four years, and had not paid any of the bonds which had matured during that time, and had in its treasury a sufficient amount of actual cash with which to pay said deficiencies, and when it was shown without dispute that in May, 1943, the property values had so increased, and the revenues of the District had been so enhanced as to make the District perfectly solvent and able to meet and pay all of its then-existing obligations as and when they matured. In addition to the fact that the taxable values of the property in the District had increased very materially, it could have been shown that the State of Texas had increased the school apportionment to the respondent District from \$27,000.00 per year to \$30,000.00 per year.

It is apparent from the statement of the trial court above quoted that it was his idea the opinion of the Circuit Court in the first appeal was res adjudicata to all issues relating to the solvency or the ability of the District to pay more than 65c on the dollar of its indebtedness.

In affirming the judgment of the trial court, the Circuit Court of Appeals in the present appeal stated:

"The District Court thought this Court had not authorized a re-consideration of that matter and declined to hear further evidence on it. We think the former opinion of the court dealt fin-

ally with that question, and reopened the Plan for Amendment for the sole purpose of removing discrimination in the mode of payment. The Amendment did that." (R. 59-60).

Petitioners submit that since the Circuit Court reversed the judgment of the trial court confirming the first amended plan of composition, it thereby reversed same for all purposes, and left the trial court free to either approve or disapprove any amended or supplemental or new plan of composition. In other words, petitioners submit that in a bankruptcy proceeding brought by a local taxing unit for the composition of its debts, the Circuit Court of Appeals does not have the power to permit a plan of composition to be amended in the Circuit Court.

Subdivision (e) of paragraph 403 of Title 11 of the Bankruptcy Act provides specifically:

"Before a plan is confirmed, changes and modifications may be made therein, with the approval of the judge after hearing upon such notice to the creditors as the judge may direct, subject to the right of any creditor who shall previously have accepted the plan to withdraw his acceptance."

In this connection petitioner calls the court's attention to the fact that the respondent School District in its motion for rehearing on the first appeal stated affirmatively that it could not amend its plan of composition to conform to the court's opinion, and that a reversal of the cause would amount to a denial of the respondent School District to have a composi-

tion of its debts. In spite of this allegation, however, the Circuit Court overruled the motion for rehearing with a written opinion (133 F. (2) 196).

There was, therefore, no reason for the petitioners filing any application to the Supreme Court for writ of certiorari, or for taking any other action until and/or unless a new plan of composition was filed in the trial court.

The last amended plan of composition was more favorable to the creditors of the respondent School District, who held its bonds, namely, the RFC and the Permanent School Fund, in that said amended plan proposed to pay interest on the new bonds from May 20, 1940, while the old plan was to issue bonds bearing 4% interest from the date of their issuance, thereby giving the RFC, as well as the Permanent School Fund, two years' interest more than that provided in the original plan, and which, unquestionably, influenced the RFC to accept the new plan of composition.

In addition, the new supplemental plan proposed to give the RFC bonds or cash not only for its old bonds but for the \$16,000.00 in time-warrants which it held, thereby enabling the RFC to collect in cash 65c on the dollar of its time-warrants, which, under the law of Texas, were illegal and not collectible. The supplemental plan of composition filed states:

“The District proposes to pay each of the holders of its outstanding bonds, either in cash or in

4% serial bonds, the sum of 65c for each \$1.00 of the principal amount of their respective claims, with interest on the reduced amount at 4% per annum from May 20, 1940." (R. 5-6).

The RFC owned over ninety-two per cent of the bonded indebtedness, and \$16,000.00 in time-warrants. Under the new plan, the RFC is able to collect in cash 65c on the dollar of the time-warrants, which the trial court originally held, and which the Supreme Court of Texas has definitely held were and are not valid obligations against the District. (*City State Bank v. Wellington Independent School District*, 178 S.W. (2) 114).

So far as petitioners have been able to find, the direct question hereinabove discussed has not been directly passed upon by the Supreme Court of the United States. In the cases of *Ecker v. Western Pac. Ry. Corp.*, 87 Law Ed. 650, and *Institutional Investors v. Chicago, M. St. P. & P. R. Co.*, 87 Law Ed. 688, it appears that the trial court did, when the final plan of composition was approved some several years after the original petition was filed, hear evidence on question as to the then solvency of petitioner, and held after hearing the evidence that conditions had not improved or changed since the original petition was filed. It is significant that in each of said cases the trial court did hear evidence at the time it approved the final plan of composition.

Petitioners submit that the construction placed on the Bankruptcy statute by the Circuit Court of

Appeals is not equitable or fair to the creditors of the local taxing unit. In these days property values in various sections have rapidly increased or decreased, as the case may be. In the case at bar the property values in the Tabasco Independent School District during the last few years have vastly increased, and under the allegations of the petitioner Permanent School Fund of Texas, which is not in any way denied or impeached, the property values of said District in 1943 were abundantly sufficient for the respondent to pay all of its bonded indebtedness in full. If these facts are true, then petitioners submit it would be a travesty on justice, and contrary to all rules of equity to permit said District to settle its debts for 65c on the dollar.

Petitioners submit that the Circuit Court of Appeals, even if it had desired to do so, could not reverse the original amended plan of composition, because same was unfair to the Permanent School Fund of Texas, and at the same time definitely, permanently, and for all time determined that the District was insolvent, and thereby prevent the trial court from hearing evidence and considering this question before it finally approved the final plan of composition submitted by the taxing unit.

STATEMENT, ARGUMENT AND AUTHORITIES UNDER POINT THREE

POINT THREE (restated): The error of the court in holding that the evidence showed that the Tabasco Consolidated Independent School District

was not able to pay more than 65c on the dollar of its indebtedness.

Petitioners submit that under the undisputed record in this case, the trial court was in error in approving the plan of composition, and the Circuit Court of Appeals was likewise in error in affirming said judgment, because the record shows that the respondent Tabasco Independent School District was and is able to pay more than 65c on the dollar of its indebtedness.

The only testimony offered by the respondent relative to its financial condition, and/or its ability to meet its obligations, is contained in the testimony of its Secretary, Mr. Walker. He testified that the highest average annual debt service cost to pay the District's outstanding bonds in full would be \$22,537.50. (O.R. 82). He testified that he had worked out for the RFC the budget for the probable future operations of the school, which would be required to be used each year, and itemized same, which totaled \$43,400.00 per year. (R. 144). He testified that they received from the State School apportionment each year \$27,000.00; that the District had a total property assessed value of \$3,000,000.00, which would produce at \$1.50 tax rate \$45,000.00. (O.R. 145).

A simple mathematical calculation shows from the above figures that the \$45,000.00 collected from the school tax, added to the \$27,000.00 received from the State of Texas totaled \$72,000.00 per annum as

revenue for the District. Subtract therefrom the \$43,400.00 required to run the budget each year, would leave \$28,600.00, with which to service the bonds. Under the statement of Mr. Walker the maximum required to service all of the bonds outstanding is \$22,537.50; subtracting this from said amount it would leave a surplus each year of \$6,062.50.

Petitioners submit that under this short, plain, concrete statement of the Secretary of the respondent School District, no reasonable mind could say that the District is able to pay only 65c on the dollar of its principal debt, without paying any portion of the unpaid interest. In addition, Mr. Walker testified that in August, 1941, the District then had on hand cash in the fund set aside to pay said bonds \$20,803.84. (O.R. 84). Why the trial court did not require the District to use this fund then on hand to retire part of the outstanding past-due interest and bonds, the respondent has not and does not attempt to say, neither did the trial court give any reason therefor.

In addition, the Act creating the respondent Independent School District provides specifically that the entire \$1.50 tax levied for bond purposes must be used, first, to service all outstanding bonds, and the remaining portion, if any, may be used by the District to run the District and pay its annual budget.

Petitioners have copied the material portions of the Act creating the respondent School District before in this brief, page 15;

Under said special statute, the Respondent District is authorized to incur any amount of indebtedness which it can service within the maximum term of years (to-wit, forty years), for which independent school districts in Texas are allowed to issue bonds, provided said bonds can be amortized within said forty years, by levying a tax of one and one-half per cent of its total assessed valuation. (R. S. Article 2786).

The general law (Article 2784, Revised Civil Statutes of Texas) governing independent school districts, limits the amount of bond taxes to fifty cents per hundred dollars; otherwise, said statute is couched in almost the identical language used in the Special Act creating the Tabasco School District, which authorizes all bonds to be issued that can be amortized with a tax levy of one and one-half per cent on the assessed valuation. In construing the general law, the Supreme Court of Texas in the case of *Bankers Life Co. v. Breckenridge Ind. School Dist.*, 128 Tex. 203, used this language:

“ * * * A reading of Section 14 of the Act of 1921 discloses that it authorizes the issuance of bonds up to the amount that a 50-cent tax levy will service. It is true that the statute does not name the maximum amount in dollars, but it states the maximum by a mathematical formula which is just as definite. Under the terms of this statute districts are not restricted to a single bond issue, but they can vote and issue successive bond issues, so long as the statutory debt limit is not exceeded.”

Under the rule laid down in the Bankers Life case, *supra*, if the plan of composition, as approved by the trial court, is confirmed, and the appellee District issues the \$298,000.00 in four per cent bonds, then it can immediately vote a large amount of additional bonds against the District, provided same can be amortized by a tax rate of \$1.50 per hundred. The result of approving the plan now offered by the District will result in the District's again being able to issue a large block of bonds, which the Attorney General could not refuse to approve. Appellant submits that the plan as approved is not fair, and is not even "corn-field justice."

In the *City of Austin v. Cahill*, 88 S.W. 542, the Supreme Court of Texas used this language:

"It is a very generally recognized rule that, in appropriating or disposing of tax funds, money raised for a specific purpose cannot be used for any other purpose.' 27 Am. & Eng. Ency. of Law, 2d Ed. p. 807. The reason is quite obvious. Since the fund is raised for the benefit of a particular class, it is in a special sense impressed with a trust for that class, and hence to divert it would necessarily be to misapply it. The principle was given effect by this court in *City of Sherman v. Williams*, 84 Tex. 421, in which it was held that taxes raised to pay the interest and provide a sinking reserve to satisfy designated indebtedness was a special fund, and could not be diverted or used for some other purpose."

It is therefore apparent that, if the entire \$45,000.00 raised by the \$1.50 tax rate to service the

bonds was used for said purpose, it would not require more than one-half thereof, because Mr. Walker testified that the utmost or greatest amount that would be required to service all of the outstanding bonds for any one year would be \$22,537.50. (O.R. 82).

STATEMENT, ARGUMENT AND AUTHORITIES UNDER POINT FOUR

POINT FOUR (restated): The error of the trial court in holding that the plan of composition approved was fair to the State Permanent School Fund of Texas, because it appears that the bonds held by the RFC bore interest at from one to five per cent per annum, and all of the bonds held by the Texas State Permanent School Fund bore five per cent, and none of the interest had been paid for more than four years. The record shows that the RFC purchased its bonds at 65c on the dollar, presumably because of the small interest rate said bonds bore. The plan approved by the court required the Texas Permanent School Fund to accept 65c on the dollar of its principal, and allow the RFC the same price, plus allowing the RFC to collect 65c on the dollar on \$16,000.00 illegal and uncollectible warrants, which it held.

Respondents submit that the plan of composition approved by the trial and Circuit courts in this case is unfair to the State Permanent School Fund of Texas, because:

(1) The record shows, as hereinbefore dis-

cussed, that the District is able to pay the bonds in full, and if not, a much more substantial amount than 65c on the dollar.

(2) It requires the Permanent School Fund to surrender 5% bonds and take 4% for 65c of their face value, and it gives to the RFC 4% bonds for its bonds which bear one, two and three per cent., and gives the RFC 65c on the dollar in bonds for its principal indebtedness, plus paying to the RFC 65c on the dollar on \$16,000.00 of time-warrants, which are invalid and uncollectible, and are not valid obligations against the District.

(3) Petitioners submit that the plan of composition for a local tax unit which permits it to pay its debts for a sum admittedly less than it is able to pay is not fair or equitable to its creditors. The Bankruptcy Act was not made as a vehicle for local taxing units to hide behind, and fail to pay their just obligations, if and/or when said local taxing units are able to pay same. The record shows in this case that the respondent under the facts was and is abundantly able to pay more than 65c on the dollar. The record further shows without dispute that the petitioner could have shown that the District was now, or was at the time of the final approval of the plan of composition, able to pay its debts and that it had on hand a sufficient amount of actual cash to pay off practically all of its delinquent interest and delinquent bonds.

(4) Neither is the plan fair, nor should it be

approved, because in the case at bar the RFC with bonds which bore only one, two and three per cent interest prior to 1955 was given bonds bearing 4% interest per annum, and in addition thereto permitted to collect 65c on the dollar of \$16,000.00 illegal and uncollectable time-warrants, while at the same time the petitioner was required to take 65c on the dollar on its bonds, which bore 5% interest per annum.

The record shows that the respondent Independent School District has only two creditors, namely, the RFC and the Texas Permanent School Fund. Petitioners submit that under the plan as approved the RFC has been and is given the best end of the deal.

WHEREFORE, petitioners pray that the plan of composition as approved by the trial court and the Circuit Court of Appeals be disapproved by this court, and that the judgment of the Circuit Court be reversed, and this cause be remanded to the trial court.

Respectfully submitted,

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